In the Supreme Court of the United States

OCTOBER TERM, 1972

No. 72-592

CITIES SERVICE OIL COMPANY, SUCCESSOR BY MERGER TO COLUMBIAN FUEL COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the Court of Claims (Pet. App. 17-26) is reported at 462 F. 2d 1134.

JURISDICTION

The judgment of the Court of Claims was entered on July 14, 1972. (Pet. App. 17.) The petition for a writ of certiorari was filed on October 12, 1972. The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

QUESTION PRESENTED

During the years 1949 through 1958, petitioner reported $1,345,000 in gross income from certain sales of natural gas, and, for tax purposes, deducted (and paid

no taxes on) 27½ percent of that amount as a depletion allowance. In 1959, petitioner refunded $1,345,000 to customers as overcharges attributable to the years 1949 through 1958. The question presented is whether under Section 1341(a)(5) of the Internal Revenue Code of 1954, which permits petitioner to reduce its 1959 income tax liability by the decrease in prior years' taxes which would result if the overcharges were excluded from the income reported for such years, the decrease in prior years' taxes attributable to the overcharges must be computed by including the savings in taxes attributable to the depletion deductions (27½ percent of the overcharges) taken by petitioner in those years.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of Sections 611, 613 and 1341 of the Internal Revenue Code of 1954 and Section 1.1341-1 of the Treasury Regulations on Income Tax (1954 Code) are set forth in the appendix to the petition at pp. 26-32.

STATEMENT

During the taxable years 1949 through 1958, petitioner,[1] a producer of natural gas, properly reported the amount of $1,345,000 in its gross income from certain sales of natural gas. In determining its taxable income for each of these years, petitioner claimed and was allowed a depletion deduction equal to 27½ percent of this amount, or $369,875. In 1959, under threats of

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[1] "Petitioner" refers to the Columbian Fuel Company, which was the taxpayer during the years in issue. This suit is brought by Cities Service Oil Company, successor by merger to Columbian.

litigation, petitioner refunded the entire $1,345,000, attributable to excessive rate charges made during the period 1949 through 1958, to two of its customers. (Pet. App. 17-18.) The correct treatment of this repayment on petitioner's 1959 income tax return is the subject of the instant suit.

Under Section 1341(a)(5) of the Internal Revenue Code of 1954 (Pet. App. 27-28), which is controlling, petitioner is entitled to reduce its 1959 income tax liability by an amount equal to the decrease in prior years' taxes which would result if the overcharges were excluded from petitioner's gross income for such years. Petitioner took the position that it was entitled to exclude the entire $1,345,000 from its prior years' income and to compute the resulting decrease in its taxes for those years without regard to the dependent 27½ percent depletion deduction taken and allowed. The Commissioner determined that the amount of taxes resulting from exclusion of the $1,345,000 from prior years' income should have been computed with reference to the depletion allowance. (Pet. App. 18-19.) Thus, the Commissioner's reduction of petitioner's 1959 income tax liability was equal to the taxes resulting from exclusion of the overcharges from prior years' income after deducting the 27½ percent depletion allowance—that is, the tax on 72½ percent of the overcharges, which was the actual tax petitioner paid when it included the overcharges in its prior years' income. On motions for summary judgment, the Court of Claims sustained the Commissioner's determination.

ARGUMENT

The decision below is correct and is consistent with

the rationale of this Court's opinion in *United States* v. *Skelly Oil Co.*, 394 U.S. 678. There is no conflict or other reason for further review.

1. The facts of this case are indistinguishable from those of *United States* v. *Skelly Oil Co.*, *supra*, where the taxpayer sought relief under Section 1341(a)(4) of the Internal Revenue Code. (Pet. App. 28.) That section allows a deduction from current income for the repayment of any amounts previously taken into income under the claim of right doctrine. In holding that the deduction in the year of repayment must be reduced by the percentage depletion deduction allowed when such amounts were taken into income, this Court noted (p. 685):

> In essence, oil and gas producers are taxed on only 72½% of their "gross income from the property" whenever they claim percentage depletion. The remainder of their oil and gas receipts is in reality tax exempt. We cannot believe that Congress intended to give taxpayers a deduction for refunding money that was not taxed when received.

Although the present case arises under Section 1341(a)(5) of the Code,[2] the *Skelly Oil* holding applies with equal force. Here, petitioner argues for a result which would entitle it to recover taxes on the 27½ percent of its "gross income from the property" which, as a result of the percentage depletion allowance, was

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[2] Section 1341 requires use of the subsection which will produce the "lesser" tax. In *Skelly Oil*, the computation under Section 1341(a)(4) produced this result. In the instant case, taxpayer realized a greater tax benefit by following Section 1341(a)(5).

originally tax exempt. The Court of Claims correctly determined that this Court's holding in *Skelly Oil Co.* would not permit such a result.

2. Section 1.1341-1(d)(4), Treasury Regulations on Income Tax (1954 Code) (Pet. App. 31-32), which is directly in point, is reasonable and consistent with the statutory provision, as well as with the legislative history. The regulation provides that in making the computation under Section 1341(a)(5), an appropriate adjustment must be made for any deduction in the prior years' income tax returns which was dependent upon "the amount of adjusted gross income, taxable income, or net income (such as charitable contributions, foreign tax credit, deductions for depletion, and net operating loss)." Thus, under the regulation, petitioner was required to reduce the repaid amounts previously included in income by the 27½ percent depletion deduction in order to compute their tax effect in prior years. The Committee Reports, as well, while not specifically mentioning the depletion deduction, cite examples of deductions dependent upon adjusted gross income or taxable income, which must be accounted for to compute the true tax effect of inclusion of refunded amounts in prior years' income. See H. Rep. No. 1337, 83d Cong., 2d Sess., p. A294; S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 451-452.

Petitioner argues, however (Pet. 10-12), that the depletion deduction was not mentioned in the Committee Reports because it is not dependent upon the amount of adjusted gross income or taxable income, but, rather, relates to "gross income from the property." The regulation in question, however, accurately

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reflects the broader principle manifested by the Committee Reports—that, under Section 1341(a)(5), to compute properly the amount of taxes attributable to inclusion of the repaid items in prior years' income, allowance must be made for any correlative deductions. The approach petitioner suggests would give petitioner a tax refund on 100 percent of its repaid "gross income from the property" even though, as a result of the dependent depletion deduction, it paid taxes on only 72½ percent of that income when received. Accordingly, the court below properly sustained the validity of the regulation as a proper exercise of the Commissioner's authority. See *Bingler* v. *Johnson*, 394 U.S. 741.[5]

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[5] Petitioner contends that *Skelly Oil* should be reconsidered because the decision in that case relied upon a proposed Treasury Regulation which was not formally adopted. It is not clear why the proposed regulation cited in *Skelly Oil* was never adopted, but, in any event, the rationale of that regulation is embodied in Section 1.1341-1(d)(4) of the current Regulations, on which we rely here. Furthermore, the proposed regulation was only one of a number of factors which the court in *Skelly Oil* cited in support of its decision.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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